A

MITSUBISHI CORPORATION & ORS

v.

SEPANGAR BAY POWER CORPORATION SDN BHD & ORS

B

HIGH COURT MALAYA, KUALA LUMPUR
KANG HWEE GEE J
[SUIT NO: D8-22-1714-2008]
2 DECEMBER 2008

C

CONTRACT: *Performance bond - Bank issuing bond - Interlocutory injunction - Whether call on bonds fraudulent and/or unconscionable - Agency - Whether bonds unconditional - Serious question to be tried - Erinford injunction - Whether appeal may be rendered nugatory*

D

CIVIL PROCEDURE: *Injunction - Call on performance bond - Interlocutory injunction - Whether call on bonds fraudulent and/or unconscionable - Agency - Whether bonds unconditional - Serious question to be tried - Erinford injunction - Whether appeal may be rendered nugatory*

E

BANKING: *Performance bonds - Call on bond - Interlocutory injunction - Whether call on bonds fraudulent and/or unconscionable - Agency - Whether bonds unconditional - Serious question to be tried - Erinford injunction - Whether appeal may be rendered nugatory*

F

Enclosure 3 was an application by the plaintiffs for an interlocutory injunction under O. 29 r. 1 of the Rules of the High Court 1980, while encl. 22 was the defendants' application to set aside the interim *ex parte* injunction obtained by the plaintiffs pending the hearing *inter partes*. The application arose from two performance bonds issued by one Mizuho Corporate Bank of Japan ('Mizuho') and one HSBC Bank ('HSBC') respectively for the contractors (all the three plaintiffs) to guarantee the performance of works carried out by them for the 1st defendant in respect of an Engineering, Procurement and Construction Contract ('EPCC'). The plaintiffs had completed Phase 1 of the contract; the performance bonds to be enforced thus were in respect of the performance of contract in Phase 2. The issues requiring consideration were as follows: (i) since there had been an absolute assignment of the two letters of guarantee from the 1st defendant to the 2nd defendant, it was first necessary to

G

H

I

determine whether the 1st defendant had legally made a valid call on the letters of guarantee issued by Mizuho and HSBC; and (ii) if the 1st defendant had validly exercised the call on the letters of guarantee on behalf of the 2nd defendant, the next step was to determine whether the restraining order should be granted.

Held (dismissing the application; encl. 22 subsumed by encl. 3):

(1) The 1st defendant was acting, under the circumstances, as an agent of the 2nd defendant in making the call on the bonds on the two financial institutions. The correspondence between the 1st and 2nd defendants, on the facts, clearly indicated the existence of such agency between them for the purpose of making the calls on the two bonds. Accordingly, the 1st defendant had made a valid call on both the guarantees. (paras 10 & 11)

(2) The facts showed that the bonds were unconditional to the extent that the 1st defendant would be entitled to call upon them at its own subjective decision, no matter whether it was right or wrong to make the call and whether it was in breach of its obligations under the EPCC or any contract. The words "due performance" in cl. 5.1.1 of the EPPC must be interpreted to mean any failure on the contractors to perform their part of the contract and should encompass any delay in such performance which attracts liquidated ascertained damages, which in the present instance was the delay in completing Phase 2 of the contract. The employer, in making a call on the bonds, was merely exercising its right under the bonds for an aspect of non-performance of the contract on the part of the contractors. As the plaintiffs were non-parties to the bonds, their rights to apply for this injunction could only be justified if the employer had acted fraudulently, unconscionably and not *bona fide* in exercising the option to call on the bonds. This was not so in the present case. There was, therefore, no serious question to be tried, and no need to proceed to the second stage of enquiry to decide on whose side the balance of convenience fell; the application ought to be dismissed. (paras 13, 14 & 15)

(3) The plaintiff's subsequent application for an Erinford injunction in terms of encl. 3 pending appeal to the Court of Appeal was also disallowed since there was no ground to grant the injunction. Inasmuch as the plaintiffs may be prejudiced by the possibility that their appeal may be rendered nugatory, the 1st defendant may be deprived of its right under a contract to receive the benefit of the bonds on an urgent and immediate basis. The 1st defendant should be perfectly able to return any money that it collected from the financial institutions in the event that the decision of this court were reversed by the Court of Appeal – given that it was an independent power producer with a long term concession. The fact that its financial statement may not have shown a good situation was not the sole criteria for determining its solvency. (paras 21 & 22)

Case(s) referred to:

Barclay Mowlem Construction Ltd v. Simon Engineering (Australia) Pty Ltd [1991] 23 NSWLR 451 ***(refd)***

Bocotra Construction Pte Ltd & Ors v. Attorney General (No 2) [1995] 2 SLR 733 ***(refd)***

Kvaerner Singapore Pte Ltd v. UDL Shipbuilding (Singapore) Pte Ltd [1993] 3 SLJ 350 ***(refd)***

LEC Contractors (M) Sdn Bhd v. Castle Inn Sdn Bhd & Anor [2000] 3 CLJ 473 CA ***(refd)***

Phua Corp Sdn Bhd v. Newacres Sdn Bhd [1992] 4 CLJ 2179; [1992] 3 CLJ (Rep) 274 HC ***(refd)***

Royal Design Studio Pte Ltd v. Chang Development Pte Ltd [1991] 2 MLJ 229 ***(refd)***

United Trading Corporation SA And Murray Clayton Ltd v. Allied Arab Bank Ltd And Others [1985] Vol 2 CA 554 ***(refd)***

Legislation referred to:

Contracts Act 1950, ss. 135, 139, 140, 149

Rules of the High Court 1980, O. 29 r. 1

Other source(s) referred to:

Pollock & Mulla Indian Contract & Specific Relief Acts, 12th edn, vol II, p 2073

For the plaintiffs - P Gananathan (Olivia Loh & Karen Ng with him); M/s Gananathan Loh

For the 1st defendant - Rajendra Navaratnam (EP Eow with him); M/s Azman, Davidson & Co

For the 2nd defendant - YY Wong; M/s Shook Lin & Bok

For the 3rd defendant - Anis Hashim; M/s Shearn Delamore & Co

Reported by Suresh Nathan

JUDGMENT

Kang Hwee Gee J:

This Is My Oral Judgment

[1] Enclosure 3 is an application by the plaintiffs for an interlocutory injunction under O. 29 r. 1 of the Rules of the High Court 1980.

[2] Enclosure 22 is an application by the defendants to set aside the interim *ex parte* injunction obtained by the plaintiffs pending the hearing *inter partes*.

Enclosure 3 (hearing *Inter Partes*)

[3] This is an application by the plaintiffs for the following orders:

(i) that the 1st and 2nd Defendants, whether by themselves, their officers, servants or agents, or any of them or otherwise howsoever (whether on behalf of themselves or any other party), be restrained and an injunction be granted restraining them from taking any steps, relying on or acting upon the demand made by the 1st Defendant on 11.9.2008 upon Bank Guarantee No. GTE SBJ060016 dated 4.1.2006 issued by the 3rd Defendant (the "HSBC Bond") or receiving or utilizing proceeds of any payment made under the HSBC Bond until trial of the action herein;

(ii) that the 1st and 2nd Defendants, whether by themselves, their officers, servants or agents, or any of them or otherwise howsoever (whether on behalf of themselves or any other party), be restrained and an injunction be granted restraining them from taking any steps, relying on or acting upon the demand made by the 1st Defendant on 11.9.2008 upon the Performance Bond no. L/G No. GOE00100086394 dated 19.12.2005 as amended by the Amendment of Letter of Guarantee dated 13.1.2006 issued by the 4th Defendant (the "Mizuho Bond") or receiving or utilizing proceeds of any payment made under the Mizuho Bond until trial of the action herein;

(iii) that the 1st and 2nd Defendants, whether by themselves, their officers, servants or agents, or any of them or otherwise howsoever (whether on behalf of themselves or any other party), be restrained and an injunction be granted

restraining them from making any further calls or demands upon the HSBC Bond and the Mizuho Bond until trial of the action herein;

(iv) that the 3rd Defendant, whether by themselves, their officers, servants or agents, or any of them or otherwise howsoever (whether on behalf of themselves or any other party), be restrained and an injunction be granted restraining them from making or effecting payment under the Bank Guarantee No. GTE SBJ060016 dated 4.1.2006 issued by the 3rd Defendant (the "HSBC Bond") until trial of the action herein;

(v) that the 4th Defendant, whether by themselves, their officers, servants or agents, or any of them or otherwise howsoever (whether on behalf of themselves or any other party), be restrained and an injunction be granted restraining them from making or effecting payment under the Performance Bond no. L/G No. GOE00100086394 dated 19.12.2005 as amended by the Amendment of Letter of Guarantee dated 13.1.2006 issued by the 4th Defendant (the "Mizuho Bond") until trial of the action herein;

(vi) that such further or other relief be granted as this Honourable Court deems fit;

(vii) that the costs of and occasioned by this application be provided for.

[4] The application arose from two performance bonds issued by Mizuho Corporate Bank of Japan and HSBC Bank respectively for each of the joint venture party who made up the contractors (all the three plaintiffs) to guarantee the performance of works carried out by the plaintiffs for the 1st defendant in respect of an Engineering, Procurement and Construction Contract (EPCC). Clause 5.1.1 of the EPCC Contract provides as follows:

5.1 Subject to Clause 5.2, the Employer shall commence performing its obligations under this Contract on the Commencement Date. The Contractor shall deliver to the Employer:

5.1.1 within fourteen (14) days after the Commencement Date, performance bonds for each Phase and to be effective from the date of issue until Final Completion for each Phase, as follows:

(a) for Phase 1 in the sum of Ringgit Malaysia Eight Million Seventy Thousand Nine Hundred and Thirty (RM8,070,930.00);

(b) for Phase 2 in the sum of Ringgit Malaysia Twelve Million Two Hundred Twenty Two Thousand and Seven Hundred (RM12,222,700.00);

(c) the performance bonds for each Phase shall be duly executed by a bank authorised to do business in Malaysia and acceptable to the Employer; and

(d) *as security for the due performance of the Contractor's obligations for each Phase under this Contract.*

The Parties agree that all expenses associated with procuring, issuing and/or renewing the performance bonds for each Phase including confirmation fees, if any, shall be paid by the Contractor.

The performance bonds for each Phase shall be irrevocable and payable unconditionally upon demand. The performance bonds for each Phase shall be substantially in the form as set out in APPENDIX 11 (Form of Performance Bond) and issued in accordance with this Clause 5.1.1 and acceptable to the Financiers.

The Contractor agrees that in the event that the performance bonds issued under Clause 5.1.1 expires prior to the Final Completion of the respective Phase, the Contractor shall no later than one (1) week before the expiry of the applicable performance bond, extend the expiry date of such performance bond until the Final Completion of such Phase. In the event that the Contractor fails or refuses to extend the expiry date of the performance bonds as required, the Employer shall be entitled to call on such performance bond for its entire value, hold such monies and refund such monies without interest only when new performance bonds are issued by the Contractor to the Employer.

The Contractor undertakes that the issuer of the performance bond for each Phase shall, if and when requested by the Employer, enter into an agreement with the Financiers acknowledging and agreeing, inter alia, to the assignment of the rights of the Employer to such performance bonds to the Financiers.

> The Contractor agrees that in the event that the Employer makes any withdrawals against the performance bonds, prior to the Final Completion for each Phase the Contractor agrees that it shall replenish the value of the performance bonds to the relevant amount stipulated in Clause 5.1.1 within fourteen (14) days of any withdrawal made by the Employer.

[5] The plaintiffs had completed Phase 1 of the contract. The performance bonds to be enforced therefore are in respect of the performance of contract in Phase 2.

Mr. P. Gananathandan, Counsel For The Plaintiffs, Submits

[6] An injunction should be granted to restrain the beneficiary of the bonds as well as the two banks from acting on the performance bonds as a *prima facie* case of fraud, unconscionable conduct and lack of *bona fide* has been demonstrated. The plaintiffs say this on two principal grounds:

(i) the 2nd defendant (who enjoys the assignment and all rights and titles from the 1st defendant) has not instructed the 1st defendant to make the call on the bonds. The 2nd defendant has to make a call on the bonds as it is an assignee of an absolute assignment of the bonds in its favour. Here it was the 1st defendant who made the call. Submit: 1st defendant was not in a position to make the call without the process of re-assignee by the 2nd defendant to the 1st defendant. See *Phua Corp Sdn Bhd v. Newacres Sdn Bhd* [1992] 4 CLJ 2179; [1992] 3 CLJ (Rep) 274 HC. All that we have here is a letter from the 1st defendant to the 2nd defendant acknowledging the legal assignment and seeking consent and authority from the 2nd defendant to make the demand. Exhibit "BPMB1" to the 2nd defendant's affidavit in reply dated 3 November 2008 (encl. 26). The letter reads as follows:

> Our Ref. SBPC/BPMB_12_08_08
>
> 12 August, 2008
>
> Bank Pembangunan Malaysia Berhad
> Level 26, Menara Bank Pembangunan
> Bandar Wawasan
> No. 1016, Jalan Sultan Ismail 50724, Kuala Lumpur

Attention En. Abu Hurairah Bahari/Cik Rosenafizah Jantan
Asst. Vice President/Head/Assistant Manager Supervision/(infrastructure), Supervision.

Dear Sirs,

Assignment of Performance Bonds/Guarantees between Sepangar Bay Power Corporation Sdn. Bhd. ("the Assignor") and Bank Pembangunan Malaysia Bhd. ("the Assignee") dated 21 April 2006

We refer to the above matter and the Deed of Assignment between the Assignor and the Assignee dated 21-4-2006 ("the Deed of Assignment"). We also refer to the Letter of Guarantee No. GOE00100086394 issued by Mizuho Corporate Bank Ltd ("Mizuho Bank"), Amendments to Mizuho Bank's Guarantee dated 13-1-2006 and 15-6-2006 respectively and Bank Guarantee No. GTE SBJ060016 issued by HSBC Bank ("HSBC Bank") *(collectively referred to as Guarantees hereinafter)*, all enclosed herewith for your easy of reference.

We write to inform you that the Contractor has now delayed in fulfilling its obligations under the Contract and we are entitled to claim liquidated ascertained damages ("LAD") from the Contractor. As the sum of money 'that we are entitled to withhold under the Contract is less than the sum of money we are entitled to impose as LAD on the Contractor, we wish to call on the Guarantees.

As we have legally assigned all the rights and benefits on the abovesaid Guarantees to you, we require the following from you:

(i) BPMB's consent and authority to make the demands; and

(ii) Original copy of the Guarantees from Mizuho Bank and HSBC Bank assigned to you *via* Notice of Assignment dated 8 May 2006.

We have prepared two (2) draft demands as annexed in Annexure A1 and Annexure B1 to be issued by us to HSBC Bank and Mizuho Bank respectively, enclosed herewith for your easy reference.

Kindly confirm that you consent and authorize us to make the demands in the form as annexed in Annexure A and Annexure B by signing and returning the proforma letter attached on your letterhead.

We thank you in advance for the co-operation and assistance rendered with regards to the matter above. In the meantime, please do not hesitate to contact the undersigned at (Tel. 03-27806688) should you require any further information or clarification on the above matter.

Thank you.

Yours faithfully,

For and on behalf
Sepangar Bay Power Corporation Sdn Bhd

Sgd.
Datuk Chris Low
Chief Executive Officer

2nd defendant did grant the request by two letters which read as follows: (Enclosure 21 exh "LSW4".)

Ref. No.: SK-PlNF:2005(40100)/1-2

27 Aug 2008

To: Sepangar Bay Power Corporation Sdn Bhd

We hereby consent and authorize you, Sepangar Bay Power Corporation Sdn. Bhd. (Company No. 427649-X), to make a demand on Letter of Guarantee No. GOE00I00086394 dated 19th December 2005 ("the Guarantee") issued by Mizuho Corporate Bank Ltd. ("Mizuho Bank") and to instruct Mizuho Bank to make payment into Project Account bearing Account No. 1401-0005628-71-8 in Bank Muamalat Malaysia Berhad at Kuala Lumpur Main Branch, Level 1, Podium Block, Menara Bumiputra, Jalan Melaka, 50100 Kuala Lumpur ("the Project Account") as stipulated in the Deed of Assignment dated 21st April 2006 entered into between Sepangar Bay Power Corporation Sdn. Bhd. and Bank Pembangunan Malaysia Berhad (formerly known as Bank Pembangunan dan Infrastruktur Malaysia Berhad) (Company No: 16562-K) ("the Deed of Assignment") and the Notice of Assignment dated 8th May 2006 issued by Sepangar Bay Power Corporation Sdn. Bhd. to Mizuho Bank ("the Notice of Assignment").

We consent to you making a demand in the form as attached and for requiring money payable under the Guarantee to be paid into the Project Account as stipulated in the Deed of Assignment and Notice of Assignment.

Yours faithfully
For and on behalf
Bank Pembangunan Malaysia Berhad

Sgd.	Sgd.
(Zakaria Saad)	(Jamaluddin Nor Mohamad)
Vice President/Head	Chief Operating Officer
Business Development	
& Advisory	

Ref. No.: SK-PlNF:2005(40100)/1-2

27 Aug 2008

To: Sepangar Bay Power Corporation Sdn Bhd

We hereby consent and authorize you, Sepangar Bay Power Corporation Sdn. Bhd. (Company No. 427649-X), to make a demand on Bank Guarantee No. GTE SBJ060016 for RM3,221,000.00 ("the Guarantee") issued by HSBC Bank Malaysia Berhad (Company No. 127776-V) ("HSBC Bank") and to instruct HSBC Bank to make payment into Project Account bearing Account No. 1401-0005628-71-8 in Bank Muamalat Malaysia Berhad at Kuala Lumpur Main Branch, Level 1, Podium Block, Menara Bumiputra, Jalan Melaka, 50100 Kuala Lumpur ("the Project Account") as stipulated in the Deed of Assignment dated 21st April 2006 entered into between Sepangar Bay Power Corporation Sdn. Bhd. and Bank Pembangunan Malaysia Berhad (formerly known as Bank Pembangunan dan Infrastruktur Malaysia Berhad) (Company No: 16562-K) ("the Deed of Assignment") and the Notice of Assignment dated 8th May 2006 issued by Sepangar Bay Power Corporation Sdn. Bhd. to HSBC Bank ("the Notice of Assignment").

We consent to you making a demand in the form as attached and for requiring money payable under the Guarantee to be paid into the Project Account as stipulated in the Deed of Assignment and Notice of Assignment.

Yours faithfully
For and on behalf
Bank Pembangunan Malaysia Berhad

A

Sgd.	Sgd.
(Zakaria Saad)	(Jamaluddin Nor Mohamad)
Vice President/Head	Chief Operating Officer
Business Development	
& Advisory	

B But subsequently in its latest affidavit the 2nd defendant has denied that it instructed the 1st defendant to make the call on the performance bonds.

Unless there is a re-assignment from the 2nd defendant back
C to the 1st defendant of the bonds the 1st defendant cannot legally make the calls on the bonds.

I also submit that the assignment of the bonds is not a private arrangement between the 1st and 2nd defendants
D because the assignment requires notice to be given to the plaintiffs as well as the 3rd and 4th defendants. The same applies with any re-assignment of the rights under the bonds to the 1st defendant.

E (ii) The call on the bonds was not made *bona fide*, was unconscionable and fraudulent as they have no honest belief as required under the underlying EPCC Contract that they could rely on the bonds to claim any money which they think is due to them on the grounds of non-performance under the
F EPCC Contract. The bonds themselves in their recital (identical) made reference to cl. 5.1.1 of the EPCC Contract. Clause 4 deals with physical execution of the work. Clause 5.1.1 read with cl. 4 therefore means that performance of obligations under the contract means physical performance of
G the works under the contract. But the 1st defendant has come out with an affidavit to state that the plaintiffs' obligations are legal obligations in this instance when they made the call on the bonds to set off LAD payment. Under cl. 10.4 of the EPCC Contract the 1st defendant's right to set off the LAD
H has been expressly limited against the remaining payment of the contractor due to the plaintiffs. If this is insufficient then the mechanism provides that unless the plaintiffs dispute the payment of LAD by reference to dispute resolution, the plaintiffs would be required to pay the balance LAD within 30
I days failing which the 1st defendant is entitled to commence proceeding to recover the balance LAD.

When a plaintiff is seeking to restrain the bank on a call on the performance bond, the bank need not be concerned with the underlying contract upon which the bond was given.

There is fraud, unconscionability and lack of *bona fide* in the call on the bonds. Clause 5.1.1 of the underlying contract read with cl. 4 envisaged that the bonds would be issued as securities for the due performance of the contractor's obligation for each phase of the contract. We humbly submit that the bonds in this case were issued only to secure the physical performance of obligation between a predetermined set of dates under the contract. In the present case, the 1st defendant issued a certificate of substantial completion on 12 August 2008, thereby certifying physical completion of works under phase 2.

It is undisputed that the 1st defendant made the call on the bonds to set off LAD under the contract, and in doing so they have now stated on affidavit that they were merely exercising their rights on the failure by the plaintiffs to fulfill their legal obligation under the contract.

Clause 10.4 of the underlying contract sets out the mechanism for the recovery of LAD. It expressly provides that the 1st defendant is entitled to set off LAD against contract payment due to the plaintiffs. Any balance and subject to whether the issue of LAD is referred to arbitration, the plaintiffs are given 30 days to make payment of LAD failing which the 1st defendant is entitled to commence recovery proceedings. The plaintiffs had referred the dispute LAD to dispute resolution under Dispute Resolution Clause. The call on the bonds was fraudulent, unconscionable and lacking in *bona fide.* Agreed if there is no such elements then we are not entitled to the injunction as we are just a third party without any right on the bond. The 1st defendant did not honestly believe and was reckless without believing in the truth when they made the demand citing non performance on the part of the plaintiffs. Referring back to the bonds, the 2nd paragraph of the bonds requires the 1st defendant when making a return demand to state in writing that the contractor is in default of its obligation under the contract. Applying *Edward Owen*'s case, the 3rd and 4th defendants (issuers of the bonds) had notice of the fraud and unconscionability before the payment was sought to be made under the bonds. See *Royal Design*

Studio Pte Ltd v. Chang Development Pte Ltd [1991] 2 MLJ 229; *Kvaerner Singapore Pte Ltd v. UDL Shipbuilding (Singapore) Pte Ltd* [1993] 3 SLJ 350. *Barclay Mowlem Construction Ltd v. Simon Engineering (Australia) Pty Ltd* [1991] 23 NSWLR 451 per Rolfe J at 462:

> Finally, it lies ill in the mouth of the defendant, in my opinion, in these proceedings that it can breach its contract with the plaintiff by calling-up the bond and the Court, exercising jurisdiction in Equity, will then leave the plaintiff to its rights and damages for that breach.

Balance of convenience – once fraud or unconscionability is established the balance of convenience becomes superfluous. Defendants cannot argue that damages are an adequate remedy per Justice Karthigesu JA in *Bocotra Construction Pte Ltd & Ors v. Attorney General (No 2)* [1995] 2 SLR 733. If at all balance of convenience is relevant then I submit there is probability that plaintiffs may not be able to recover what has been paid out under the bonds as it is financially unstable. See search of the company – current liability exceeds current asset whereas plaintiff Mitsubishi is solvent.

Mr. Rajendra Navaratnam For The 1st Defendant

[7] Only two issues raised by the plaintiffs to support their application:

(i) On the absolute assignment issue;

(ii) On the fraud, unconscionability and lack of *bona fide* issue to justify application for injunction where the contracting parties are the bank and the beneficiaries and not the plaintiffs.

(i) **On the absolute assignment** – totally agree that there was absolute assignment on performance bonds and therefore 1st defendant has no more right to exercise the call on the bonds. The only way is to obtain consent and authorization from the 2nd defendant on whom the bonds had been assigned to in order to make a call on the bonds. Once you get consent and authority to make the call then in law you become constituted as the agent of the assignee (the 2nd defendant). See ss. 135, 139, 140 and 149 of the Contracts Act 1950 which read as follows:

135 "Agent" and "principal"

An "agent" is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the "principal".

139 Agent's authority may be expressed or implied

The authority of an agent may be expressed or implied.

140 Definitions of express and implied authority

An authority is said to be express when it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted circumstances of the case.

149 Right of person as to acts done for him without his authority. Effect of ratification

Where acts are done by one person on behalf of another but without his knowledge or authority, he may elect to ratify or to disown the acts. If he ratifies them, the same effects will follow as if they had been performed by his authority.

There is a valid call by agency of the 1st defendant on the bonds. The authorization letter from 2nd defendant to the 1st defendant expressly consented and authorized the 1st defendant to make a demand on the relevant letter of guarantee. The 1st defendant did make the call on the two banks by the letters exhs. "P11" and "P12" in encl. 2. See *LEC Contractors (M) Sdn Bhd v. Castle Inn Sdn Bhd & Anor* [2000] 3 CLJ 473 per Mokhtar Sidin JCA (call on the bond made by solicitor).

Here in our case 1st defendant has acted as agent for the 2nd defendant in making the calls on the bonds.

(ii) **The Second Issue On Fraud, Unconscionability And Lack Of *Bona Fide***

(a) See cl. 5.1.1 of the EPCC Contract (the underlying contract) – provides for "as security for the due performance of the contractor's obligations" in both phases. It is not restricted to physical performance as the performance of

A obligations under the EPCC Contract will have to include both physical and legal obligations (meaning the contractual obligations) of the plaintiffs. The contractual obligations would include the obligation to pay the liquidated damages. The plaintiffs had not paid the LAD claimed by the 1st
B defendant but had instead chosen to exercise their rights to refer to arbitration. So 1st defendant exercised the option to call on the bonds. The terms and conditions in the bonds were accepted by the parties and were unconditional payable on demand.

C

(b) See *LEC Contractors (M) Sdn Bhd v. Castle Inn Sdn Bhd & Anor* [2000] 3 CLJ 473 per Mokhtar Sidin JCA at 499:

> First of all we wish to point out that the authorities we have referred above clearly indicated that in order
D to justify any injunction to stop payment there must be clear evidence of fraud on the part of the first defendant which comes to the knowledge of the second defendant. Bad faith or unconscionable conduct by itself is not fraud.
>
E …
>
> …
>
> With the greatest respect to the learned counsel for the plaintiff, not only fraud was not specifically
F pleaded but also it is clear to us the instances of fraud that he had stated in his submission are not instances of fraud but disputes between the parties. It is clear from the authorities those disputes must be settled between the parties and they would not
G affect the performance bond.

Only fraud is recognized not unconscionable conduct.

(c) In any case there is no evidence of any fraud, unconscionable conduct or lack of *bona fide* on the part of 1st defendant
H in its decision to make a call on the bond. The 1st defendant exercised the right to call on the bonds on the basis that the performance of both physical and contractual obligations under the contract had not been fulfilled as there was delay in completion and hence the
I 1st defendant is entitled to liquidated damages and to make call on the bonds.

[8] Reply By Mr. Gananathan

i. There is no principal agent relationship existing in the present case between the 1st defendant and the 2nd defendant to allow the 1st defendant to act for the 2nd defendant. If anything it is the 2nd defendant that has to make the call. First, the only contract between the 1st and 2nd defendants is the deed of assignment which does not provide for such an agency. Second, on three occasions, the 1st and 2nd defendants have come out with an affidavit to state that the 2nd defendant did not instruct the 1st defendant to make the call on the bonds. Therefore applying s. 135 of the Contracts Act 1950, the 1st defendant cannot be seen as acting for the 2nd defendant or representing the 2nd defendant in its dealing with the 3rd party. And third, the 2nd defendant's right to call on the bonds are quite different and distinct from the 1st defendant's right. In this context the 1st defendant enjoyed superior right and hence no agency relationship could have risen. The right of the 2nd defendant is found in cl. 6.1 of the Assignment of Performance Bonds/Guarantees encl. 21 exh. "LSW3" where the 2nd defendant enjoys the right to call on the bonds if the 1st defendant is in default of its facility. The humble submission is that no principal agent relationship exists. See *Pollock & Mulla Indian Contract & Specific Relief Acts* 12th edn, vol. II at p. 2073:

> A mortgagee with power to sell the mortgaged property without intervention of court, is not an agent of the mortgagor in selling the property. The mortgagee's right is different from that of the mortgagor. The former's right is a superior right which is not under the mortgagor but it is against him. In other words, the sale is against the morgagor's wishes. The rights and interests of the mortgagor and the mortgagee in regard to the sale of the mortgaged property are conflicting.

The decision in *LEC Contractors, supra*, is distinguishable in that the solicitors who issued the demand as agent were clearly doing so under the instruction of their client ie, the beneficiary of the bonds.

ii. The 1st defendant did not call on the bonds because the bonds were not extended. They called on the bonds on the pretext of setting off LAD without even complying with the mechanism under the contract which allows the plaintiff a period of 30 days to pay the balance LAD upon setting off of the contract price (which was already set off by then). The best solution to this issue would have been for the plaintiff to have extended the bonds (which they were prepared to do), for the 1st defendant to withdraw its demand, and for the parties to proceed to arbitration on the issue of LAD. This is all evidence of fraud within the context of *Barclay Mowlem Construction Ltd v. Simon Engineering, supra.*

iii. The fraud test cannot be taken to its illogical end to the extent that the exception of fraud itself becomes unworkable. As per Ackner LJ in *United Trading Corporation S.A. And Murray Clayton Ltd v. Allied Arab Bank Ltd. And Others* [1985] Vol. 2 CA 554 at 561:

> Moreover, we would find it an unsatisfactory position if, having established an important exception to what had previously been thought an absolute rule, the Courts in practice were to adopt so restrictive an approach to the evidence required as to prevent themselves from intervening.

Findings And Decision

[9] As there had been an absolute assignment of the two letters of guarantee from the 1st defendant to the 2nd defendant, it would be necessary first and foremost to determine whether the 1st defendant had legally made a valid call on the letters of guarantee issued by the two financial institutions – Mizuho Corporate Bank of Japan and HSBC Bank, the issuers of the respective letters of guarantee.

[10] I accept the submission of counsel for the 1st defendant that the 1st defendant was acting under the circumstances as an agent of the 2nd defendant in making the call on the bonds on the two financial institutions. The correspondence between the 1st and 2nd defendants clearly indicates the existence of such agency between them for the purpose of making the calls on the two bonds. The first letter dated 12 August 2008 clearly sought in no uncertain terms the consent and authority to make the demands

on the Mizuho Corporate Bank of Japan and HSCB Bank on the respective bonds. In the letter the 1st defendant appears to have given the reason for the need to make the calls on the bonds on the contractor's delay "in fulfilling its obligations under the contract and we are entitled to claim liquidated ascertained damages ("LAD") from the contractor". The letter demonstrates that a relationship pertaining to the assignment of the bonds exists between them and that the request for the consent to act was made in furtherance of such relationship. The reply by the 2nd defendant was unequivocal by its two letters of the same date consenting to and authorizing the 1st defendant to make a demand on the Letter of Guarantee No. GOE00100086394 of Mizuho Bank and HSBC Bank's Guarantee No. GTE SBJ060016. It does not now lie in the mouth of the 2nd defendant to now say in its affidavit after the calls had been made, that it did not "instruct" the 1st defendant to make the call on the two bonds after having consented and authorized the 1st defendant by its two letters to "make a demand" on the two letters of guarantee.

[11] Accordingly I must so find that the 1st defendant had made a valid call on both the guarantees.

[12] Having determined that the call on the letters of guarantee had been validly exercised by the 1st defendant on behalf of the 2nd defendant the next step is to determine whether the restraining order sought for should be granted by asking the two questions in *American Cyanamid* (as approved and applied in *Keet Gerald Francis*).

[13] Is There A Serious Question To Be Tried?

i. The cl. 5.1.1 in the EPCC Contract specifying the need for the 2nd and 3rd plaintiffs to provide the performance bonds for the two phases of the contract did not specify exactly the terms and conditions by which the 1st defendant may call on the bonds. However, the intention of the parties respecting the right of the 1st defendant to call on the bonds can be discovered from the letters of the two bonds that were subsequently issued. They contained the following operative common phrases as follows: "We hereby consent and authorize you, Sepangar Bay Power Corporation Sdn Bhd (Company No. 427649-X), to make a demand …"

A ii. It is clear that the bonds were unconditional to the extent that the 1st defendant would be entitled to call upon them at its own subjective decision no matter whether it was right or wrong to make the calls and whether it was in breach of its obligation under the EPCC or any contract.

B iii. There is no reason to read the word "performance" in cl. 5.1.1 of the EPCC Contract to mean only to "physical performance" as submitted by counsel for the plaintiffs. The words "due performance" must be interpreted to mean any C failure on the part of the contractors to perform their part of the contract and should encompass any delay in such performance which attracts LAD (Liquidated Ascertained Damages). The submission that the 1st defendant is not entitled to enforce its claim of LAD against the performance D bonds is untenable. The fact remains that there is a claim now pending against the contractors and LAD in essence is merely a pre-determined quantum by which the employer had agreed should be paid where there is a failure on the part of the contractors to perform an aspect of the contract (in the E present instance the delay in completing both phase II of the contract).

iv. There is no reason to find that by exercising its option to make a call on the bonds the employer can be said to have F acted fraudulently, unconscionably and non *bona fide*. In making a call on the bonds the employer is merely exercising its right under the bonds for an aspect of non-performance of the contract on the part of the contractors.

v. The law is clear. As the plaintiffs are non-parties to the bonds G their rights to apply for this injunction can only be justified if the employer had acted fraudulently, unconscionably and non *bona fide* in exercising the option to call on the bonds. This is not so in the present case.

H **[14]** There is no serious question to be tried. There is no need to proceed to the second stage of the enquiry to decide on whose side the balance of convenience falls.

[15] The application is dismissed with costs.

I **[16]** Enclosure 22 is subsumed by encl. 3. Accordingly, there shall be no order on this enclosure.

Erinford Injunction

Mr. P. Gananathan, Counsel For The Plaintiffs

[17] I am instructed to apply for an Erinford Injunction in terms of encl. 3 pending the appeal to the Court of Appeal. My instructions are the plaintiffs are prepared to prosecute their appeal on an urgent basis. If the Erinford Injunction is not granted the appeal will be rendered nugatory. As set out in the affidavit of the 1st defendant, it is submitted, is commercially insolvent, which will go to the question of recoverability. If the court finds the terms of encl. 3 to be too wide, as an alternative the plaintiffs submit that the monies be at the very least kept in the escrow account.

Mr. Rajendra Navaratnam, Counsel For The 1st Defendant

[18] I object. The principle is clear in Erinford and an Erinford Injunction will only be granted where it can be shown in the particular circumstances of the case that the appeal will be rendered nugatory. The only ground that has been suggested for this by the plaintiffs is that they alleged that the 1st defendant is commercially insolvent. The 1st defendant is not commercially insolvent. See our latest company search exh. "LSW14" of encl. 24 showing that there is an excess of approximately RM66,943,823 over liabilities. The employer is an operator of an independent power station which was granted the licence to operate the station on long term basis of 15 years. That is the test – no evidence that this appeal would be rendered nugatory.

Reply By Mr. Gananathan

[19] My learned friend is wrong to suggest that the only ground advanced on the nugatory point is the insolvency of the 1st defendant. They are two distinct issues. The appeal will be rendered nugatory as once payment is effected pursuant to the demand a call would have been made on the performance bonds which would have an effect on the plaintiffs. Paragraph 26(c) and (d)) of encl. 2 sets out that the plaintiffs are well established companies and that their reputation would be affected, there would be loss of confidence in the market and the chances to tender for future contracts would be affected. That is why we say it is nugatory.

[20] On the insolvency point, I refer to the updated company search "LSW14" encl. 24 and the test being the current liabilities exceed current assets to constitute commercial insolvency, we respectfully submit the current liabilities as at p. 39 of the exhibit is RM62,550,935 whereas the current assets is RM45,254,625.

Decision ***(Ex-tempore)***

[21] There is no ground to grant an Erinford Injunction as applied for by the plaintiffs. In as much as the plaintiffs may be prejudiced by the possibility that their appeal may be rendered nugatory the 1st defendant may be deprived of its right under a contract to receive the benefit of the bonds on an urgent and immediate basis. The 1st defendant should be perfectly able to return any money that it collects from the financial institutions in the event that the decision of this court is reversed by the Court of Appeal – given that it is an independent power producer with a long term concession. The fact that its financial statement may not have shown a good financial health is not the sole criteria for determining its solvency.

[22] The application is disallowed.